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**FINANCE & RECORDS**

## **MEMO**

To: Gregg Mandsager, City Administrator

From: Nancy A. Lueck, Finance Director

Date: June 12, 2018

Re: In Depth Discussion Item – Utility Franchise Fee Rate Review

### **Introduction:**

The fiscal year 2018/2019 budget was adopted based on factors known at the time the budget was developed and adopted. The most significant known factor at that time was a reduction of an estimated \$300,000-\$350,000 in Automated Traffic Enforcement (ATE) fine revenue in the General Fund since the IDOT had ordered the ATE camera at University and Highway 61 to be turned off. The budget included an increase in the Utility Franchise Fee from 1% to 5% which is expected to generate an additional \$325,600 in revenues. The City adopted the ordinance increasing the franchise fee rate from the current 1% to 5% on March 15, 2018 to allow for the required 90 day notice to Alliant Energy to implement this rate change. This franchise fee increase allowed for the City to offset the impact from the expected continued loss of the ATE revenue, to maintain the same property tax rate for FY 2018/2019, and to maintain the current level of General Fund services to residents of the community.

There were also concerns at the time the budget was adopted as to whether the State legislature would reduce or eliminate the backfill funding for the commercial and industrial property rollback (estimated at a total of \$643,700). While the legislature adjourned this year without reducing or eliminating the backfill funding, the uncertainty in this funding will continue in future years and it is likely that this funding will again be a discussion item in the next or future legislative sessions.

Recently the Iowa Supreme Court ruled in favor of cities appealing the IDOT ATE removal orders and the ATE at University and Highway 61 will again be operational on June 18, 2018. This is expected to result in an additional \$300,000 in revenues to the General Fund for FY 2018/2019.

**"I remember Muscatine for its sunsets. I have never seen any  
on either side of the ocean that equaled them" — Mark Twain**

## **Discussion Items:**

The expected additional revenue of \$300,000 from the ATE camera at University Avenue and Highway 61 will add that amount to the General Fund revenues and General Fund balance based on known factors at this time. Attached is a General Fund budget fund statement that shows the impact of this additional revenue and also shows various scenarios which address possible future concerns for continued backfill funding and potential future legislative impacts which could restrict ATE revenue going forward. Discussion items are reflected in various scenarios on this spreadsheet and include:

1. Continuing the 5% Utility Franchise Fee which along with the University ATE revenue will increase the General Fund balance to 22.8% of General Fund expenditures (the same percentage as the FY 17 ending fund balance before the ATE revenue was reduced). This increased fund balance would put the City in a better financial position in future years to address possible future reductions in the State backfill or future ATE restrictions and the ability to maintain current City services. It would also address increasing the General Fund balance as discussed during the recent budget process. The \$300,000 fund balance increase can be considered as a portion of the fund balance designated to address future revenue shortfalls due to legislative changes.
2. The attached spreadsheet also shows varying levels (4%, 3%, 2%, and 1%) of the Utility Franchise Fee and the impacts these would have on the fund balance.
3. The spreadsheet (first two columns on page 2) show “worst case” scenarios if the State legislature would fully eliminate the backfill and also legislatively eliminate ATEs beginning in FY 2019/2020. Maintaining the 5% Franchise Fee rate in FY 19 would put the City in a better position to address City service levels if the “worst case” would occur.
4. The final 3 columns on page 2 of the spreadsheet show the scenario where the City continues to receive the same level of ATE fines, but shows a phase-out period of 3 years (FY 20, FY 21, and FY 22) for the State backfill. These columns reflect the 5% Franchise Fee rate for all years (including FY 19) which would put the City in a better position to address reductions in the backfill funding, which is likely to happen in future legislative sessions.
5. Also attached is the General Fund Balance Policy. I have highlighted several areas on the 2<sup>nd</sup> page of the policy. While the minimum fund balance has been set at 16.7% of General Fund expenditures, the policy specifically states that balances of 20-25% would further add to the financial stability of the City. With the Utility Franchise Fee in place at 5%, it may be an opportunity to increase the fund balance in order to address the expected future year revenue fluctuations (backfill funding).

## Summary:

These scenarios are based on assumptions shown on the schedule and are for discussion and planning purposes only. Each budget year efforts are made to position the City for future year budgets and this should also be taken into account while considering any changes to the Utility Franchise fee. In addition to the assumptions noted on this schedule, City Council would also need to consider changes in the property tax rate to maintain current levels of services provided to our residents in future year budgets.

Additionally, formally amending the General Fund Balance Policy to reflect a higher minimum fund balance can be discussed during the In Depth meeting as part of the review of the Utility Franchise Fee.

It is staff's recommendation to keep the Utility Franchise Fee rate at 5% to better position the City to address legislative challenges due to the uncertainty of future backfill funding and potential changes restricting use of ATEs. Reducing the Franchise Fee at this time would only make these issues more challenging in future budgets. Please remember that the City has been very conservative in its budgeting and has not had a property tax rate increase for the last nine years.

Following is information from the proposed budget on the impact to the average residential home owner from the increase in the Utility Franchise Fee from 1% to 5%:

**"The impact of the Utility Franchise fee increase from 1% to 5% to a home owner with the average annual gas costs of \$596 would be \$24 for the year. This increase would be partially offset by the decrease in property taxes due to the residential rollback (\$20 reduction for the owner of a \$100,000 home)."**

**General Fund  
Fund Statement**

FY 2018/2019 with Different Levels of Franchise Fees										
	Actual 2015/2016	Actual 2016/2017	Budget 2017/2018	Revised Estimate 2017/2018	Adopted Budget 2018/2019	Adopted Budget with Estimated University ATE Rev. & 5% Franchise Fee* 2018/2019	Adopted Budget with Estimated University ATE Rev. & 4% Franchise Fee* 2018/2019	Adopted Budget with Estimated University ATE Rev. & 3% Franchise Fee* 2018/2019	Adopted Budget with Estimated University ATE Rev. & 2% Franchise Fee* 2018/2019	Adopted Budget with Estimated University ATE Rev. & 1% Franchise Fee* 2018/2019
Beginning Balance, July 1	\$ 3,907,012	\$ 4,072,014	\$ 4,356,665	\$ 4,312,391	\$ 4,212,888	\$ 4,212,888	\$ 4,212,888	\$ 4,212,888	\$ 4,212,888	\$ 4,212,888
Revenues	17,813,345	19,121,436	19,385,894	19,409,048	20,252,302	20,252,302	20,252,302	20,252,302	20,252,302	20,252,302
Estimated ATE Fines - University						300,000	300,000	300,000	300,000	300,000
If Reduce Utility Franchise Fee						0	(81,400)	(162,800)	(244,200)	(325,600)
If ALL ATE Fines would be Eliminated (Future Years)						0				
If Commercial/Industrial Backfill Eliminated or Phased Out (Future Years)										
Encumbrance Variance	6,397	55	0	0	0	0	0	0	0	0
Funds Available	\$ 21,726,754	\$ 23,193,505	\$ 23,742,559	\$ 23,721,439	\$ 24,465,190	\$ 24,765,190	\$ 24,683,790	\$ 24,602,390	\$ 24,520,990	\$ 24,439,590
Expenditures	17,654,740	18,881,114	19,412,851	19,508,551	20,165,500	20,165,500	20,165,500	20,165,500	20,165,500	20,165,500
Ending Balance, June 30	\$ 4,072,014	\$ 4,312,391	\$ 4,329,708	\$ 4,212,888	\$ 4,299,690	\$ 4,599,690	\$ 4,518,290	\$ 4,436,890	\$ 4,355,490	\$ 4,274,090
Increase (Decrease) in Fund Balance	\$ 165,002	\$ 240,377	\$ (26,957)	\$ (99,503)	\$ 86,802	\$ 386,802	\$ 305,402	\$ 224,002	\$ 142,602	\$ 61,202
Minimum Fund Balance per policy adopted in November, 2013 (16.7% of General Fund Expenditures)	\$ 2,948,000	\$ 3,153,000	\$ 3,242,000	\$ 3,258,000	\$ 3,368,000	\$ 3,368,000	\$ 3,368,000	\$ 3,368,000	\$ 3,368,000	\$ 3,368,000
Amount Over (Under) Fund Balance Policy Minimum of 16.7%	\$ 1,124,014	\$ 1,159,391	\$ 1,087,708	\$ 954,888	\$ 931,690	\$ 1,231,690	\$ 1,150,290	\$ 1,068,890	\$ 987,490	\$ 906,090
Ending Balance as a Percent of General Fund Expenditures	23.1%	22.8%	22.3%	21.6%	21.3%	22.8%	22.4%	22.0%	21.6%	21.2%
Same % as the Actual FY 17 Ending Fund Balance										
Each 1% of the Utility Franchise Fee is estimated at \$81,400.										

Same % as the Actual FY 17 Ending Fund Balance

\* Each 1% of the Utility Franchise Fee is estimated at \$81,400.

	FUTURE YEARS IMPACTS WORST CASE		IP Keep ATEs and 3-Year Phase-Out of State Backfill			
	PRELIMINARY FUTURE YRS If Maintain 5% Franchise Fee	PRELIMINARY FUTURE YRS If Reduce FY 19 to 1% Franchise Fee (FY 20 to 5%)	FY 20 Est. if 3-Yr Backfill Phase-Out If Maintain 5% Franchise Fee & Keep ATEs	FY 21 Est. if 3-Yr Backfill Phase-Out If Maintain 5% Franchise Fee & Keep ATEs	FY 22 Est. if 3-Yr Backfill Phase-Out If Maintain 5% Franchise Fee & Keep ATEs	
Beginning Balance, July 1	\$ 4,599,690	\$ 4,274,090	\$ 4,599,690	\$ 4,572,221	\$ 4,119,789	
Revenues	20,657,348 (1)	20,657,348 (1)	20,657,348 (1)	21,070,495 (1)	21,491,905 (1)	
Estimated ATE Fines - University	300,000	300,000	300,000	300,000	300,000	
If Reduce Utility Franchise Fee	0	0	0	0	0	
If ALL ATE Fines would be Eliminated (Future Years)	(650,000) (3)	(650,000) (3)	0 (3)	0 (3)	0 (3)	
If Commercial/Industrial Backfill Eliminated or Phased Out (Future Years)	(643,700) (4)	(643,700) (4)	(214,352) (4)	(429,348) (4)	(643,700) (4)	
Incumbance Variance	0	0	0	0	0	
Funds Available	\$ 24,263,338	\$ 23,937,738	\$ 25,342,686	\$ 25,513,368	\$ 25,267,994	
Expenditures	20,770,465 (2)	20,770,465 (2)	20,770,465 (2)	21,393,579 (2)	22,035,386 (2)	
Ending Balance, June 30	\$ 3,492,873	\$ 3,167,273	\$ 4,572,221	\$ 4,119,789	\$ 3,232,608	
Increase (Decrease) in Fund Balance	\$ (1,106,817)	\$ (1,106,817)	\$ (27,469)	\$ (452,432)	\$ (887,181)	
Minimum Fund Balance per policy adopted in November, 2013 (16.7% of General Fund Expenditures)	\$ 3,469,000	\$ 3,469,000	\$ 3,469,000	\$ 3,573,000	\$ 3,680,000	
Amount Over (Under) Fund Balance Policy Minimum of 16.7%	\$ 23,873	\$ (301,727)	\$ 1,103,221	\$ 546,789	\$ (447,392)	
Ending Balance as a Percent of General Fund Expenditures	16.8%	15.5%	22.0%	19.3%	14.7%	

- Each 1% of the Utility Franchise Fee is e
- Future Year Assumptions:**
1. Assumes 2% increase in revenues
  2. Assumes 3% increase in expenditures
  3. Worst case impact if 100% of ATE revenues eliminated by State legislature
  4. Worst case impact of loss of all of State Backfill (this would, however, likely be phased out over 3-6 yrs)
- Future Year Assumptions:**
1. Assumes 2% annual increase in revenues
  2. Assumes 3% annual increase in expenditures
  3. Assumes ATE revenue is maintained and Franchise Fee at 5% ALL years
  4. If Backfill would be phased out over 3 years beginning in FY 20

**City of Muscatine, Iowa**  
**General Fund Balance Policy**  
**Adopted November 7, 2013**

**Purpose of Policy**

The purpose of this policy is to establish a key element of the financial stability of the City by setting guidelines for the General Fund balance. The Unreserved/Unassigned General Fund balance is an important measure of the City's financial stability. It is essential that the City maintain adequate levels of General Fund balance to (1) mitigate financial risk that can occur from unforeseen revenue fluctuations, (2) fund unanticipated expenditures including those which may result from natural or other disasters, (3) provide cash flow liquidity to fund expenditures throughout the fiscal year, and (4) demonstrate financial strength to credit rating agencies who assign bond ratings at the time general obligation bonds are sold. Credit rating agencies determine the adequacy of the unassigned fund balance using a complex series of financial evaluations. The size of the fund balance is an important, but not the only consideration in the City's rating. Other important factors are the reliability of a government's revenue sources, economic conditions, community wealth factors, cash position, debt ratios, management performance, and fiscal decisions made by the legislative body.

**Definitions**

**Fund Balance.** The difference between assets and liabilities in governmental funds of the City, including the General Fund, is Fund Balance.

The Governmental Accounting Standards Board (GASB), who establishes financial reporting rules for governments, separates fund balance into five classifications that comprise a hierarchy based primarily on the restrictions placed on the funds.

- 1. Nonspendable.** This classification represents funds that are inherently nonspendable. Resources that must be maintained intact pursuant to legal or contractual requirements are nonspendable, as well as assets that will never convert to cash such as inventory or prepaid items
- 2. Restricted.** These funds are limited by externally enforceable limitations on use. This includes limitations from the entity providing the money, such as grantors. Also, this classification includes funds with limitations placed by law or enabling legislation.
- 3. Committed.** Funds in this classification are those with limitations the government places on itself. The purpose of these funds is decided by Council action and also requires Council action to change the purpose.
- 4. Assigned.** Assigned fund balance has limitations based on the intended use of the funds. The assigned use can be established by the City Council, the City Administrator, or Finance Director. This classification includes outstanding purchase orders, funds assigned for future equipment purchases, funds assigned for future grant commitments, and similar items.
- 5. Unassigned.** Residual net resources, or the balance after restricted, committed and assigned, are classified as unassigned fund balance. This is the amount of fund balance that is available to address emergencies and provide fiscal stability. This is the classification governed by this Fund Balance Policy.

### Minimum Fund Balance Policy

The Government Finance Officers Association of the United States and Canada (GFOA) recommends that cities of any size maintain an unrestricted/unassigned General Fund balance of no less than two months of regular general fund operating revenues or expenditures, whichever is more predictable. For the City of Muscatine expenditures have historically been used to make this computation since expenditures vary less throughout each fiscal year. **Two months of expenditures is equivalent to a fund balance of 16.7% of General Fund expenditures and this is the level targeted to be the new minimum General Fund balance at the end of each fiscal year.**

The City Council during each budget review process may consider setting a ***budgeted*** ending balance less than the minimum percent noted above. It is suggested this be no less than 15% of budgeted General Fund expenditures but can be evaluated on a year-to-year basis by City Council. This can be considered since historically in all recent years the actual ending General Fund balances have exceeded the estimates developed during the budget process.

**General Fund balances in excess of the minimum level, up to 20-25%, would further add to the financial stability of the City and allow more latitude in addressing revenue or expenditure fluctuations, disaster situations, and demonstrate credit worthiness to bond rating agencies. City Council, as a part of the budget process, can also choose to use fund balances above the minimum level for one-time capital purchases to reduce the amount of debt and resulting interest costs to be incurred by the City.**

### Other Policy Provisions

**Maintaining Fund Balance.** In the event that the unassigned general fund balance is calculated to be less than the policy states, the City shall plan to adjust budget resources or expenditures in the subsequent fiscal year(s) to restore the balance.

**Utilization of Fund Balance.** Except in extraordinary circumstances, unassigned fund balance should not be used to fund any portion of the ongoing and routine operating expenditures of the City. It should be used primarily to respond to unforeseen emergencies, to provide cash flow, and to provide overall financial stability.

Extraordinary circumstances can include significant revenue fluctuations (i.e. State legislative changes limiting property taxes, limiting automatic traffic enforcement (ATE) use, etc.). In the event that use of unassigned fund balance is necessary to provide a short-term solution to maintaining essential services, the City will evaluate current and future economic conditions to evaluate the extent of expenditure reductions or revenue increases that would be needed to achieve day-to-day financial stability and restore the fund balance.

**Administrative Responsibilities.** The Finance Director shall be responsible for monitoring and reporting the City's various fund balance assignments. The City Administrator is responsible for making recommendations to the City Council on the use of any unassigned fund balance above the minimum level as an element of the annual operating budget process and from time to time throughout the year if the need arises.

**Annual Report.** The Finance Director shall annually submit a report to the City Council outlining the status of the City's various components of the fund balance. This is to be included with the fiscal year-end financial report to City Council.

Draft Policy Dated: October 7, 2013